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TRANSCRIPT OF RECORD

20

Supreme Court of the United States

OCTOBER TERM, 1927 8

No. ~~575~~ 17

GILBERT C. GREENWAY, JR., PETITIONER,

vs.

FRANK K. BOWERS, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 3, 1927

CERTIORARI GRANTED NOVEMBER 21, 1927

(33,027)

(33,027)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927

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IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

Writ of Error

United States of America, ss:

The President of the United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, or some of you, between Gilbert C. Greenway, Jr., Plaintiff, and Frank K. Bowers, Collector of United States Internal Revenue for the Second District of the State of New York.

A manifest error hath happened to the great damage of the said Frank K. Bowers, Collector of United States Internal Revenue for the Second District of the State of New York, as is said and appears by the complaint. We being willing that such error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the Judges of the United States Circuit Court of Appeals for the Second Circuit, at the City of New York, together with this writ, so that you have the same at the said place, before the Judges aforesaid, on the 16th day of December, 1926, that the record and proceedings aforesaid being inspected, the said Judges of the [fol. 2] United States Circuit Court of Appeals for the Second Circuit may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

Witness, the Honorable William H. Taft, Chief Justice of the United States, this 17th day of November, in the year of our Lord one thousand nine hundred and twenty-

six, and of the Independence of the United States the one hundred and fifty-first.

Alex Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, in the Second Circuit.

The foregoing writ is hereby allowed. Henry W. Goddard, U. S. District Judge.

[fol. 3] IN UNITED STATES DISTRICT COURT

GILBERT C. GREENWAY, JR.,

against

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York

SUMMONS

To the above-named defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service. In case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the Honorable, Augustus N. Hand, Judge of the District Court of the United States for the Southern District of New York, at the City of New York, this 26th day of May, A. D. 1926.

Alex. Gilchrist, Jr., Clerk. Baldwin, Hutchins & Todd, Plaintiff's Attorneys.

Office and Post Office Address: 120 Broadway, Borough of Manhattan, City of New York.

[fol. 4] IN UNITED STATES DISTRICT COURT

[Title omitted]

COMPLAINT

Plaintiff by his attorneys, Baldwin, Hutchins & Todd, complaining of the defendant respectfully shows to this court:

First. That at all times hereinafter mentioned, plaintiff was and now is a citizen of the United States and a resident of the City, County and State of New York, in said Southern District of New York.

Second. Upon information and belief that the above named defendant is a citizen of the United States, and a resident of the Borough of Manhattan, City, County and State of New York, and was on the 15th day of March, 1923, and has been at all times since said date the Collector of the United States Internal Revenue for the Southern District of New York.

Third. That during the years 1921 and 1922, one John C. Greenway, plaintiff's brother, was the owner of 10,000 [fol. 5] shares of the capital stock of Ahumada Lead Company, a corporation organized under the laws of the State of Delaware, for which he had paid the sum of $1.00 per share, or a total of $10,000.

Fourth. That on or about the 29th day of March, 1921, said John C. Greenway gave and delivered to the plaintiff, without the payment of any consideration therefor 5000 shares of said stock; that the market value of said 5,000 shares of stock on said day was $13,750.

Fifth. That on or about the 1st day of March, 1922, said John C. Greeway, gave and delivered to the plaintiff, without the payment of any consideration therefor the remaining 5000 shares of said stock; that the market value of said 5000 shares of stock on said day was $16,250.

Sixth. That thereafter and on about the 1st day of August, 1922, plaintiff sold the said 10,000 shares of stock for the sum of $52,500, which amount was the then market value thereof.

Seventh. That on or about March 15, 1923, plaintiff duly made and filed with the defendant his return of income received during the year ending December 31, 1922, in which he reported that he had received a profit on the sale of said 10,000 shares of said Ahumada Lead Company stock of $42,500. In a note attached to said return plaintiff stated in reference to said stock "this stock was received as a gift in 1921-22; sold for $5.25 per share, cost donor $1.00 per share.

Eighth. That plaintiff reported in said return that his [fol. 6] net income for the year ending December 31, 1922, was $57,514.56, which included said sum of $42,500 reported as a profit from the sale of said 10,000 shares of said Ahumada Lead Company stock, and based thereon plaintiff paid to the defendant pursuant to Title I and Title II of the Act of Congress known as the Revenue Act of 1921" an income tax of $11,120.31 in four instalments on March 15, 1923, June 12, 1923, September 14, 1923, and December 15, 1923, respectively.

Ninth. That had the profit received by the plaintiff on the sale of said stock been reported in said return at $22,500, viz: the difference between the value of said stock when plaintiff acquired the same and the mount for which he sold the same, instead of at $42,500, as stated in said return, plaintiff's net taxable income for the ending December 31st, 1922, would have been reduced by $20,000, and the tax due thereon would have been $4,441.61 less than the tax paid by the plaintiff as heretofore alleged.

Tenth. That plaintiff reported his profit on the sale of said stock in said return at $42,500, instead of a $22,500, solely in obedience to the provisions of Section 202 (a) (2) of said Revenue Act of 1921, which provides that the basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property acquired by gift after December 31, 1920, shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift.

Eleventh. That so much of said tax paid by the plaintiff as heretofore alleged as is based on the item of $42,500 re- [fol. 7] ported by plaintiff in his said return as a profit on the sale of said stock was paid to defendant under protest

and in order to avoid the penalties imposed by law for non-payment. Said protests were in writing in the form of letters written by Baldwin, Hutchins & Todd, plaintiff's attorneys, to the Collector of Internal Revenue for the Second District of New York, the defendant herein, and were filed with said defendant at the time said tax instalments were paid. Copies of said letters are hereto annexed marked Exhibits "A", "B", "C" and "D" respectively.

Twelfth. That the levy and collection on the part of the Treasury Department of the United States and the defendant herein of an income tax against the plaintiff on the sum of $20,000, namely, the difference between the cost to said John C. Greenway, plaintiff's brother, of said 10,000 shares of capital stock of said Ahumada Lead Company, and the value of said stock at the time the same was given to the plaintiff, by said John C. Greenway, is an attempt to levy a direct tax upon the capital or property of the plaintiff, but without apportionment among the States in proportion to the population as required by Sub-Division 4, Section 9 of Article I of the Constitution of the United States. That the levy of a tax on the said sum of $20,000 is an attempt to tax as income that which was in fact capital or property of the plaintiff and not income within the provisions of Article XVI of the Constitution of the United States.

Thirteenth. That said Section 202 (a) (2) of the said Act of Congress known as "Revenue Act of 1921" in so far as it provides that, for the purpose of ascertaining the amount of gross income from which the amount of net income sub-
[fol. 8] ject to tax is to be computed, the basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property acquired by gift after December 31, 1920, shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift, is contrary to and in violation of the provisions of Sub-Division 4, Section 9 of Article I, and of Article XVI, of the Amendments to the Constitution of the United States, and, therefore, void and unenforceable.

Fourteenth. That on or about the 27th day of March, 1924, plaintiff duly made and filed with the defendant a written claim for refund of taxes, a copy of which is hereto

annexed marked Exhibit "E" wherein and whereby plaintiff demanded that the said amount of $4,441.61 be refunded and paid back to the plaintiff as a tax illegally and improperly assessed and collected.

Fifteenth. That thereafter and on or about the 15th day of December, 1924, said claim for refund of said tax was duly rejected in writing, a copy of which rejection is hereto annexed and marked Exhibit "F".

Sixteenth. That no part of said illegal tax of $4,441.61 has been refunded or repaid to plaintiff although same has been duly demanded.

Seventeenth. That this is a suit of civil nature at common law and arises under the Constitution and Laws of the United States and under the laws of the United States providing for Internal Revenue.

[fol. 9] Wherefore, plaintiff demands judgment against the defendant in the sum of $4,441.61, with interest thereon from December 15, 1923, together with the costs and disbursements of this action.

Baldwin, Hutchins & Todd, Attorneys for Plaintiff.

Office and Post Office Address: 120 Broadway, Borough of Manhattan, New York City.

Duly sworn to by Gilbert C. Greenway, Jr. Jurat omitted in printing.

[fol. 10] EXHIBIT A TO COMPLAINT

March 15, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York City, N. Y.

DEAR SIR: We are handing you herewith personal income tax return of Mr. Gilbert C. Greenway, Jr., of 61 Broadway, together with Mr. Greenway's check for $2,780.08, representing one-quarter of the amount of income — shown by such return.

Mr. Greenway has included as income in his return an item of $42,500 profit, as representing the difference between the cost to the donor and the price at which he sold 10,000 shares of capital stock of the Ahumada Lead Company which was given to him as a gift during the year 1921-1922. This amount of profit is included as income under protest and the tax thereon is paid under protest, reserving to Mr. Greenway the right to take such action as he may consider proper to recover the amount of tax paid upon such alleged profit.

Will you kindly stamp the enclosed duplicate copy of this letter so that we will have evidence that it was received by you?

Yours very truly, (Signed) Baldwin, Hutchins & Todd.

RAY:C.
Enclosures.

[fol. 11] EXHIBIT B TO COMPLAINT

June 12, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York City, N. Y.

DEAR SIR: We are handing you herewith check of Gilbert C. Greenway for the second installment of his income tax for the year 1922.

This payment is made under the same protest as accompanied the payment of the first installment of this tax on March 15, 1923.

Will you kindly stamp this letter, showing its receipt by you and return the same for our files?

Yours very truly, (Signed) Baldwin, Hutchins & Todd.

RAY:C.
Enclosure.

EXHIBIT C TO COMPLAINT

September 14, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York City, N. Y.

DEAR SIR: We are enclosing herewith check of G. C. Greenway, Jr., in payment of the third installment of his income tax for the year 1922.

[fol. 12] This payment is made under protest, reserving the right of Mr. Greenway to file a claim and sue for the refund of all or any part of such payment.

Very truly years, (Signed) Baldwin, Hutchins & Todd.

RAY:C.
Enclosure.

EXHIBIT D TO COMPLAINT

December 15, 1923.

Collector of Internal Revenue, 2nd District, Custom House, New York, N. Y.

DEAR SIR: We are handing you herewith check for $2,780 of Gilbert C. Greenway, being the final installment of his income tax for the year 1922.

This payment is made under the same protest as accompanied the first installment of this tax on March 15, 1923.

Will you kindly stamp this letter showing its receipt by you and return the same for our files?

Yours very truly, Baldwin, Hutchins & Todd.

Y. C.
Enclosure.

[fol. 13] EXHIBIT E TO COMPLAINT

Claim for Refund of Taxes Illegally Collected

STATE OF NEW YORK,
County of New York, ss:

Gilbert C. Greenway, Jr., 61 Broadway, New York, N. Y.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

Period: Year. From: 1/1/22. To: 12/31/22.
1. Business in which engaged: Broker.
2. Character of assessment or tax: ——.
3. Amount of assessment or stamps purchased: ——.
4. Reduction of Tax Liability requested (Income and Probits Tax): $——.
5. Amount to be abated: $——.
6. Amount to be refunded (or such greater amount as is legally refundable): $4,441.61.
7. Dates of payment (see Collector's receipts or indorsements of canceled checks): Total tax paid for the year 1922, $11,120.31, paid quarterly.

[fol. 14] (If statement covers income tax liability, items 8-11, inclusive, must be answered.)

8. District in which return (if any) was filed: 2nd, New York, N. Y.
9. District in which unpaid assessment appears: ——.
10. Amount of overpayment claimed as credit: $——.
11. Unpaid assessment against which credit is asked; period from —— —, ——, to —— —, ——, $——.

Deponent verily believes that this application should be allowed for the following reasons:

During the year 1921-1922, the taxpayer received as a gift 10,000 shares of Ahumada Lead Company stock. 5,000 shares were received in 1921 at a time when the market value of such stock was 2¾ per share and 5,000 shares were received in 1922 when the market value of the stock was 3¼ per share. The entire 10,000 shares were sold in 1922

for $52,500, or at 5¼ per share. The original cost of the stock to the donor was $1.00 per share and under the provisions of the Revenue Act of 1921, the taxpayer was required to report a total profit of $42,500, whereas his actual profit, based upon the difference in the value at the time of acquisition and the time of sale was $22,500. He, therefore, paid tax on a fictitious profit of $20,000.00, which makes a difference in his total tax for the year of $4,441.61. This tax was paid under protest. The taxpayer claims that the provisions of Section 202, Subdivision 2 of Para- [fol. 15] graph A are unconstitutional and invalid and for this reason requests the refund of the difference between the amount paid and the amount which would have been paid but for this provision of the law.

Gilbert C. Greenway, Jr.

Sworn to and subscribed before me this 26th day of March, 1924. Mary E. Steers, Notary Public, Bronx County. Bronx Co. Clk. No. 202, Reg. No. 527. N. Y. Co. Clk. No. 1259, Reg. No. 5084. Term expires March 30, 1925. (Seal.)

EXHIBIT F TO COMPLAINT

Treasury Department, Washington, Office of Commissioner of Internal Revenue

IT:PA:2. CRY-205. December 15, 1924.

Mr. Gilbert C. Greenway, Jr., 61 Broadway, New York, N. Y.

SIR: Your claim for refund of $4,441.61, individual income tax for the year 1922, has been examined.

[fol. 16] The claim is based upon the statement that the profit on certain stock, received by you as a gift, should be the difference between the selling price and the market value of such stock when received by you, rather than the difference between the selling price and the cost of the donor.

You are advised that Section 202 (a) (2), Regulations 62, reads in part as follows:

"In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor of the last preceding owner by whom it was not acquired by gift."

Your claim will, therefore, be rejected.

The rejection of your claim will officially appear upon the next schedule to be approved by the Commissioner.

Respectfully, (Signed) J. G. Bright, Deputy Commissioner by A. Lewis, Head of Division.

[fol. 17] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION TO DISMISS AND NOTICE THEREOF

Now comes the above named defendant by his attorney Emory R. Buckner, United States Attorney for the Southern District of New York and moves to dismiss the complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action.

Dated New York, June 17, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant.

Office & P. O. Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 18] [Title omitted]

SIR: Please take notice that the motion to dismiss the complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action, made up and on behalf of the defendant under date of June 17, 1926, will be brought on for hearing at a term of the United States District Court for the Southern District of New York at the Old Post Office Building, in the Borough of Manhattan, City of New York, on the 20th day of July,

1926, at 10:30 A. M. or as soon thereafter as counsel can be heard.

Dated New York, June 25, 1926.

Yours, etc., Emory R. Buckner, United States Attorney for the Southern District of New York., Attorney for Defendant.

Office & P. O. Address: U. S. Courts P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 19] To Baldwin, Hutchins & Todd, Esqs., Attorneys for Plaintiff, 120 Broadway, Borough of Manhattan, City of New York.

IN UNITED STATES DISTRICT COURT

[Title omitted]

OPINION

[fol. 20] KNOX, D. J.:

It is my opinion that no part or portion of the value of an outright bona fide gift as of the date of delivery is, or can, constitute taxable income in the hands of the donee. So far as the latter is concerned, the gift is a capital transaction. His liability for future income therefrom must be based on the value of the gift as of the time the transaction is complete, and not upon the cost of the property at the date of its acquisition by the donor. If the construction of the tax law, for which the Government contends, should be applied, it means that the donee of property is to be taxed upon an increment in value which, it if can be regarded as income at all, is income to another, viz: the donor. A tax levied upon that increment in the hands of the donee necessarily results in a direct levy upon the gift. If the gift consisted of money, would it be argued that the donee is to be taxed on the difference in value of the money, that is, its purchasing power, as between the date of its acquisition by the donor, and the date of its delivery to the donee? I think not. The money would be regarded as capital in the hands of the donee; and so, I think that that which may

be converted into money, as of the date upon which it is given away, must, so far as the donee is concerned, also be regarded as capital.

[fol. 21] According to my views, the 16th Amendment to the Constitution conferred no power upon the Congress to tax gifts.

Very likely, it is possible to devise reasonably plausible arguments to the effect that what is transferred by the donor is nothing more than his original investment therein, and to cite various decisions which contain expressions that may be tortured to support the argument; but the fact remains that the common understanding of a gift is that the donee acquires, absolutely and completely, the entire value of the donation as of the date of transfer. Until a higher court than this is willing to endorse a different principle, I certainly shall not do so.

The motion to dismiss the complaint is denied and the plaintiffs may have judgment for the claim asserted against the Collector. He, of course, will be granted a certificate.

August 5, 1926.

Jno. C. Knox, U. S. D. J.

[fol. 22] In United States District Court

[Title omitted]

Order Denying Motion to Dismiss

The defendant above-named, having moved this court by notice of motion dated the 17th day of June, 1926, for an order granting defendant judgment dismissing the complaint upon the ground that said complaint does not state facts sufficient to constitute a cause of action, and said motion having regularly come on to be heard before Honorable John C. Knox, one of the Judges of this court, on the 20th day of July, 1926, in the Court Room of this court in the old United States Post Office Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esq., of counsel for defendant in support of said motion, and after hearing E. Raymond Shepard, Esq., of counsel for plaintiff in opposition thereto, and the court after due

deliberation having rendered its opinion on the 5th day of August, 1926, that the said complaint states facts sufficient to constitute a cause of action;

Now, upon reading said notice of motion and said complaint, and upon said opinion of this court, all of which [fol. 23] have been filed heretofore with this court, and upon motion of Baldwin, Hutchins & Todd, attorneys for plaintiff, it is

Ordered that said motion to dismiss the complaint be and the same is hereby in all respects denied, and it is further

Ordered that plaintiff may enter judgment against defendant for the sum of Four thousand four hundred forty-one and 61/100 ($4,441.61) with interest thereon from the 15th day of December, 1923, together with the costs and disbursements of this action.

Jno. C. Knox, U. S. D. J.

AGJ.

In United States District Court

[Title omitted]

Judgment

The defendant above named, having moved this Court by notice of motion dated the 17th day of June, 1926, for an order granting defendant judgment dismissing the com- [fol. 24] plaint upon the ground that said complaint does not state facts sufficient to constitute a cause of action, and said motion having regularly come on to be heard before Honorable John C. Knox, one of the Judges of this Court on the 20th day of July, 1926, in the Court Room of this Court in the old United States Post Office Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esq., of counsel for defendant in support of said motion, and after hearing E. Raymond Shepard, Esq., of counsel for defendant, in opposition thereto, and the Court after due deliberation having rendered its opinion on the 5th day of August, 1926, denying said motion on the ground that said complaint states facts sufficient to constitute a cause of action and directing that final judgment should be granted in favor of plaintiff for

the amount demanded in the complaint, with interest, and plaintiff having thereupon duly entered an order in the office of the Clerk of the United States District Court for the Southern District of New York on the 2nd day of September, 1926, directing that said motion be denied, and that plaintiff might enter judgment against defendant for the sum of Four Thousand four hundred forty-one and 61/100 ($4,441.61) Dollars, with interest thereon from the 15th day of December, 1923, together with costs and disbursements of this action, and plaintiff having accordingly on the 11th day of September, 1926, served a copy of said order with notice of entry thereof upon the attorney for defendant.

Now, upon motion of Baldwin, Hutchins & Todd, attorneys for plaintiff, it is

Adjudged that plaintiff Gilbert C. Greenway, Jr., recover of defendant Frank K. Bowers, Collector of United [fol. 25] States Internal Revenue for the Second District of the State of New York, the sum of Four thousand four hundred forty-one and 61/100 ($4,441.61), the amount claimed in the complaint, together with interest thereon from the 15th day of December, 1923, such interest amounting to $727.21, plaintiff's costs having been taxed in the sum of $20.00, amounting in the whole to the sum of five thousand, one hundred eighty-eight and 82/100 ($5,188.82) Dollars and that plaintiff have execution therefor against defendant.

Alex. Gilchrist, Jr., Clerk United States District Court, Southern District of New York.

IN UNITED STATES DISTRICT COURT

[Title omitted]

CERTIFICATE OF PROBABLE CAUSE

The plaintiff having duly commenced this action by the service of a summons and a complaint upon the defendant, for the recovery of $4,441.61, with interest from December [fol. 26] 15, 1923, the amount of tax heretofore paid by the plaintiff to the defendant and the defendant having duly appeared herein by Emory R. Buckner, United States Attorney for the Southern District of New York and the court

having upon due deliberation denied the defendant's motion to dismiss the complaint and directed judgment in favor of the plaintiff against the defendant for the relief demanded in the complaint, and judgment in the sum of $5,188.82, having been entered by the clerk of this court on September 10, 1926, in favor of the plaintiff and against the defendant, pursuant to the order of the court entered herein September 2, 1926;

Now, therefore, pursuant to Section 989 of the Revised Statutes of the United States, I hereby certify that there was probable cause for the acts done by the defendant Frank K. Bowers, Collector of Internal Revenue for the Second District of New York which resulted in the entry of said judgment against him.

Dated New York, December 7, 1926.

Jno. C. Knox, U. S. D. J.

We hereby consent to the entry of the above certificate.

Baldwin, Hutchins & Todd, Attorneys for Plaintiff.

[fol. 27] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR WRIT OF ERROR

To the Honorable the Judges of the District Court of the United States for the Southern District of New York:

Now comes Frank K. Bowers, the defendant herein, by his attorney, Emory R. Buckner, United States Attorney for the Southern District of New York, and feeling himself aggrieved by the judgment entered herein on the 10th day of September, 1926, in favor of the plaintiff and against him, by which it was adjudged that the plaintiff have and recover of the defendant the sum of $5,188.82, and that plaintiff have execution therefor against said defendant, in which judgment and the proceedings had in this cause, certain errors were committed to the prejudice of this defendant, all of which more fully appears in the assignment of errors filed herewith;

Prays that a writ of error may be allowed to him from the United States Circuit Court of Appeals for the Second Circuit to the District Court of the United States for the Southern District of New York, for the correction of the [fol. 28] errors so complained of, and that a transcript of the record, proceedings and papers in this cause, duly authenticated, may be sent from said District Court to said Circuit Court of Appeals.

Dated New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant.

Office and P. O. Address: U. S. Courts and P. O. Bldg., Borough of Manhattan, City of New York.

IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENT OF ERRORS

Now comes the above named defendant by his attorney, Emory R. Buckner, United States Attorney for the Southern District of New York, and assigns error in the judgment of this Court entered September 10, 1926, in the following respects:

[fol. 29] 1. The Court erred in holding and deciding that the complaint stated facts sufficient to constitute a cause of action.

2. The Court erred in failing to hold that the complaint did not state facts sufficient to constitute a cause of action.

3. The Court erred in granting plaintiff's motion for judgment.

4. The Court erred in failing to deny plaintiff's motion for judgment.

5. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant for the sum of $4,441.61, interest and costs, a total of $5,188.82.

6. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant.

7. The Court erred in failing to dismiss the complaint.

8. The Court erred in failing to direct the entry of judgment in favor of the defendant and against the plaintiff, dismissing the complaint.

Wherefore defendant prays that said judgment of the District Court be reversed.

Dated New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant.

Address and Post Office Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 30] Citation, in usual form, omitted in printing.

[fol. 31] In United States District Court

[Title omitted]

Stipulation re Transcript of Record

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

Dated December 14th, 1926.

Baldwin, Hutchins & Todd, Attorneys for Plaintiff.
Emory R. Buckner, U. S. Attorney, Attorney for Defendant.

[fol. 32] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 33] In United States Circuit Court of Appeals for the Second Circuit, October Term, 1926

Nos. 280-294

Argued May 20, 1927. Decided July 5, 1927

Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

Elizabeth C. Taft, Defendant in Error (Plaintiff Below)

Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

Gilbert C. Greenway, Jr., Defendant in Error (Plaintiff Below)

In Error to the District Court of the United States for the Southern District of New York

Before Manton, L. Hand, and Swan, Circuit Judges

Opinion

In Error to the District Court of the United States for the Southern District of New York.

Actions by Elizabeth C. Taft and by Gilbert C. Greenway, Jr., against Frank K. Bowers, Collector of Internal Revenue, to recover for income taxes paid under protest. Judgments for plaintiffs; defendant appeals. Reversed.

Charles H. Tuttle, U. S. Atty., of New York City (Samuel C. Coleman, Asst. U. S. Atty., of New York City, of counsel), for plaintiff in error.

Cadwalader, Wickersham & Taft, of New York City (Henry W. Taft and Clarence Castimore, both of New York City, of counsel), for defendant in error Taft.

Baldwin, Hutchins & Todd, of New York City (Robert A. Young and E. Raymond Shepard, both of New York City, of counsel), for defendant in error Greenway.

MANTON, Circuit Judge:

These cases were argued together and will be considered in one opinion. The defendant in error Miss Taft received a gift from her father of 150 shares of the common stock of the Nash Motors Company—100 shares in December, 1921, and 50 shares in March, 1922. They were transferred on the books of the corporation in her name on December 26, 1922, when she became the record owner thereof. They were obtained by her father as a bonus in connection with the purchase of preferred stock of the Nash Motors Company. In February, 1923, the Nash Motors Company declared a stock dividend of four shares of common and three [fol. 34] shares of preferred on each share of common stock to the stockholders of record on December 26, 1922. As a result she became the owner of 750 shares of common and 450 shares of preferred stock. After the receipt of this stock, in 1923, she sold 200 shares of common and 130 shares of preferred stock for $34,345.30. The market value of her 150 shares of common at the time she received the gift from her father was $42,350. The stock which she sold in 1923 brought $11,708 more than it was worth when she received it. In making her income tax return and paying the same for 1923, she included the entire gain of the sale of the stock sold by her as income for that year. This was required by section 202 (a) of the Revenue Act of 1921 (Comp. St. § 6336½bb). She paid a tax upon the basis of the original return, and thereafter protested against the tax upon the full amount of the proceeds, arguing that she should have been required to account, as income, for the difference between the value of the stock when she acquired it and the price at which she had sold it, to wit, $11,708.80.

In Mr. Greenway's case, the action is to recover a tax paid under protest as income tax for the year 1922, payment being made in 1923. The stock sold by this defendant in error was also a gift made by his brother to him. The stock was likewise sold at a profit.

The statute involved, section 202 (a) (2) of the Revenue Act of 1921, provides:

"(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property,

real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

"(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

A profit resulting from the conversion of capital assets is income, within the Sixteenth Amendment of the Constitution. Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305; Eldorado Coal & Mining Co. v. Mager, 255 U. S. 522, 41 S. Ct. 390, 65 L. Ed. 757; Walsh v. Brewster, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762. Income from gifts is treated in the same manner as income from other sources, and income has been defined as gain derived from capital and labor or from both combined provided it be understood to include profit or gain through a sale or conversion of capital assets. Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. The statute here attacked recognized this definition of income, and measures the profit or loss upon the sale or conversion of the gift as a difference between the price which the donor paid for it and the price which the donee obtained. The value of the property at the time the donor transferred it to the donee is ignored and Congress, in effect, charged the gift with the tax which the donor would have paid had he received the market value for it at the time of the gift.

The arguments of the defendants in error are that a gift is in the nature of capital assets, and that no tax is imposed upon the gift as such. The arguments further are that, by

taxing as income the difference between the cost to the donor and the price, realized by the donee, the tax is being imposed upon the corpus of the gifts themselves, and that section 213 (b) of the statute (Comp. St. § 6336⅛ff), forbids this. But the question is whether the method adopted by Congress for measuring income is, in the case of the donee, a reasonable one in the aid of the purposes of federal income taxation. Section 213 (b) does not define what is income from a gift. The defendants in error accede to the position that what each received when they sold the property, if it shows an increase, is a profit; but, in measuring it, the price at the date each received the gift must be assumed to be its worth to them. But Congress has measured otherwise, and it says, in protecting the government against loss of revenue, it is proper that, where the donee pays nothing, it accepts as a measure of gain or loss the cost to the donor without reference to its actual value when received by the donee.

[fol. 35] The obvious purpose of section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income, even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. The value of the property is ignored or not taken into account until the property is finally disposed of in such a way that it could be determined that the owner made either a gain or a loss, and, until there is a sale, there is no necessity for measuring income, nor is there an opportunity to do so. This avoids tax evasion or tax avoidance. This statute puts the donee, who pays nothing for the property, and who therefore loses nothing, on any theory of economic principle, in the position the donor would have been, in so far as taxation is concerned.

Nor does this method of taxation suggest that the statute is unconstitutional, as in violation of the Fifth Amendment. While the power to tax is not absolute, a tax should be shown to be arbitrary and capricious before it is condemned. The power of Congress to tax as permitted under the Sixteenth Amendment must be recognized, as well as

protection under the Fifth Amendment. The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred, is essential to the entire taxing scheme. The method results in no greater tax than that which would have been imposed upon the donor and the donee, if each had been asked to pay a proportion of the tax based upon the amount of the increment when in the hands of each. Only the income from the gift is affected by the statute. It is not the donee's income from other sources. The statute is prospective in operation, and relates to gifts made after a certain date. A donee must, therefore, be charged with the knowledge that under the law the gift may be worth less to him because of the necessity of sharing part of the profits with the government—that part which had accumulated up to the time he had received the gift. The argument against the constitutionality of the section loses sight of the fact that the statute is directed toward a means for collecting the revenue which is made available under the income tax statute. Knowlton v. Moore, 178 U. S. 41, 20 S. Ct. 747, 44 L. Ed. 969; N. Y. Trust Co. v. Eisner, 256 U. S. 345, 41 S. Ct. 506, 65 L. Ed. 963, 16 A. L. R. 660.

The statute may, indeed, be said to be an execution of the main design of the Income Tax Act. That it is proper to ignore the value of property at the time of the gift is illustrated by the excess profits tax. A tax upon a donor for making a gift is not in violation of the Constitution. Anderson v. McNeir, 16 F. (2d) 970.

The Supreme Court said, in La Belle Iron Works v. United States, 256 U. S. 377, 41 S. Ct. 528, 65 L. Ed. 998: "Nor can we regard the act—in basing 'invested capital' upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the states under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course, it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds

of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation."

So here Congress, in effect, has said that, notwithstanding the value of the property, from an economic standpoint, for the purpose of this taxation, that value is ignored, and only the value when the property was acquired by the donor is considered. This is deemed necessary to the enforcement of this aspect of the Income Tax Law, where a gift is made, and where a profit or loss is afterwards realized, and it becomes necessary to make proper measurement thereof. Although popularly the gift has a fixed value at the date of transfer, there is no constitutional objection, for income tax purposes, in rejecting or in ignoring that fact, and holding that the rights transferred by the gift, which include the increment while in the hands of the donor, are subject to the tax. No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift, and the tax could have been measured by the difference between the price he paid for it and its value when he trans- [fol. 36] ferred it. Nor could it be criticized if the donee was left to pay the balance of the tax, based upon the difference between the value on the date of acquisition and the value on the date of sale.

The statute does no more than tax the donee for a gift when he sells it, and measures that income for income tax purposes as based upon the difference between the cost when acquired by the donor and the price realized by the donee. It is not capricious to put property acquired by gift in a special class, and to tax it differently from property acquired by purchase. Bowman v. Cont. Oil Co., 256 U. S. 642, 41 S. Ct. 606, 65 L. Ed. 1139; Brushaber v. Union Pac. R. R. Co., 240 U. S. 1, 36 S. Ct. 236, 60 L. Ed. 493; Thomas v. U. S., 192 U. S. 363, 24 S. Ct. 305, 48 L. Ed. 481. It is sufficient, for the main purposes of the Sixteenth Amendment and the income tax enactments pursuant thereto, if the method of taxation is consistent with the entire scheme of taxation and the tax imposed by that method may not be considered direct.

We think that Congress, in levying the tax here, was well within its constitutional power in creating a classification which was reasonable, and neither the tax nor the method of enforcing it was arbitrary or capricious. Barclay & Co. v. Edwards, 267 U. S. 442, 45 S. Ct. 135, 348, 69 L. Ed. 703.

The judgments below are reversed, with costs.

Swan, Circuit Judge, dissents.

[fol. 37] In United States Circuit Court of Appeals

[Title omitted]

Concurring Opinion

L. Hand, Circuit Judge (concurring):

In each of these cases the amount of the tax does not exceed the increase in value of the gift while in the donee's hands. Strictly speaking, the question does not therefore arise whether Congress may, as a tax on income, seize any part of the increase in value of the gift before the donee accepted it. I am not entirely sure that a tax, if limited to the increase in the donee's hands, might not be calculated upon the difference between what the donor paid and the donee got. At the argument, I was disposed to think that these cases might be decided on some such reasoning, but it is pretty clear that that would make a new statute. Congress did not mean so to limit the tax. In the first place the results would be so capricious that the validity of the law might be doubtful, and in the second, much revenue would be lost which was certainly intended to be reached. We may hardly so far strain the law to save it. So I think that this act must be good in whole or not at all.

No increase in value not realized in cash can be taxed as income under the Sixteenth Amendment; that was very deliberately decided in Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. If so, it is impossible to tax the increase in the donor's hands at all; it is not income, though at any time by a sale he could have made it such. The same increase is as little income, even after it has passed to the donee, until he sells. However,

[fol. 38] it seems to me equally clear that when he does, there has been a gain which is in every sense income, to the extent of the difference between what the donor paid and the donee got. I am not concerned for the moment with whose gain it is, but that the whole gain is income cannot, I submit, be disputed. If it is important, I suggest that the language of the Amendment itself gives Congress power to lay "taxes on incomes," not on persons. Therefore there is a subject-matter which Congress may tax without apportionment, and part of which, after Eisner v. Macomber, it could not tax in any other way, except perhaps as an excise.

I can see no injustice in regarding the whole of this gain as income of the donee, and if there be no injustice certainly it is not within the Fifth Amendment. Suppose that the law charged the corpus of the gift while in the donor's hands with an inchoate tax at specified rates, to be calculated upon its increase whenever it was sold. The donee in accepting such a gift would take it subject to that charge, though its amount would remain undetermined until he sold. I can see nothing unconstitutional in that, nor in imposing upon him a corresponding duty in personam because of his acceptance. So far as that would involve uncertainty, arising from fluctuation in value of the gift after acceptance, it would be entirely within the donee's control, for he may sell when he likes, and could scarcely complain of any increase which might result from his delay. It is true that Congress has gone further than that, because it has made the whole gain a part of his income for the year in which he sells. But again so far as that is dependent upon the amount of his other income, he can reckon with it when he accepts the gift, and of any subsequent fluctuation he takes his chance, precisely as he does of fluctuation in the value of the gift.

Therefore I fail to see any oppression in this method of calculating the tax upon what, as I have said, appears to me an unquestionable subject-matter for taxation. In Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087, the gain had accrued before the amendment went into effect. I read Gray v. Darlington, 15 Wall. 63, 21 L. Ed. 45, in the same sense, though perhaps it was only a forerunner of Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. People ex rel. Brewster v. Wendell,

196 App. Div. 613, 188 N. Y. S. 510, dealt with a statute which sought to tax the donor, and was void where Eisner v. Macomber is law. That the statute is reasonably ancillary to a valid constitutional purpose seems to me as plain as in Rice v. Eisner, 16 F. (2d) 258 (C. C. A. 2); that the practice, if permissible, will become a common contrivance to frustrate that purpose, I have no doubt whatever.

I concur with my brother Manton.

[fol. 39] In United States Circuit Court of Appeals

[Title omitted]

Dissenting Opinion

Swan, Circuit Judge (dissenting):

I am unable to agree with the result reached by my colleagues. Section 202 (a) (2) of the Revenue Act of 1921 attempts to include as income of the donee, sustained upon sale of the gift, the increment in value which accrued during the time the property was owned by the donor, or by his predecessor in title if the donor himself received it as a gift. It has been established that Congress may not tax as income what in fact is not income, without apportioning the tax according to the constitutional requirement. Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. Property obtained by gift is capital, not income in the hands of the donee upon its receipt. Edwards v. Cuba Railroad, 268 U. S. 628, 45 S. Ct. 614, 69 L. Ed. 1124; United States v. Oregon-Washington, etc., Co., 251 F. 211 (C. C. A. 2). This is expressly recognized by the declaration of section 213 (b) (3) of the Revenue Act of 1921 to the effect that gross income shall not include the value of property acquired by gift, but only the income from such property. But section 202 defines the income from such property as including the increment in value which accrued [fol. 40] before the donee became owner of the property. This is an attempt to declare to be income of the donee, when realized by sale of the gift, something which was part of the donee's capital before the sale.

In Doyle v. Mitchell Bros. Co., 247 U. S. 179, 38 S. Ct. 467, 62 L. Ed. 1054, Mr. Justice Pitney, speaking for a unanimous court, said: "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." It was held that, where the increase in capital value occurred before passage of the taxing act, such increase is not taxable as income upon sale of the property. A similar decision as to the Income Tax Act of 1913 (38 Stat. 114) appears in Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087.

I am unable to see why these cases are not applicable. The period under consideration in determining the gain realized by the taxpayer donee is the period of the donee's ownership. Only by giving an unreal valuation to the capital of the donee, namely, the cost of the gift to the donor or his predecessor in title, is it possible to consider the total gain above such cost as income to the donee realized by his sale. It does not seem to me a sufficient answer to say that the donee accepts the gift with knowledge that Congress has declared it to have this fictitious valuation for income tax purposes. The tax is not an excise on the privilege of accepting the gift; it is an income tax, and the tax payer's income must be a gain derived from his capital, or his labor, or from both combined.

It is my opinion, therefore, that the judgments should be affirmed.

[fol. 41] In United States Circuit Court of Appeals

[Title omitted]

Decree—Filed July 13, 1927

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed with costs. Further ordered that execution be issued for the collection of said costs.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

M. T. M. L. H.

[fol. 42] [File endorsement omitted.]

[fol. 43] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 44] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 21, 1927

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

The Chief Justice took no part in the consideration or decision of the petition for writ of certiorari in this case.